tion is based on the assessment that overall U.S. agricultural interests will be enhanced by open markets. Accordingly it stresses reducing foreign producer subsidies and export subsidies, and import barriers. In particular, the United States wants Japan to lower its import barriers substantially, and the European Community to reduce its domestic price supports (and variable levies) and export subsidies. To induce such concessions, however, the United States will have to consider overhauling many of its farm support programs. Most importantly, it may have to rescind its GATT waiver (the so-called Section 22 waiver) permitting it to impose import quotas; lower its price and income supports; and terminate export subsidies.

The United States also favors strengthening the GATT dispute settlement procedure for agricultural cases.

The European Community

The emergence of the European Community as a surplus producer and major exporter of many agricultural products has raised considerably the budgetary costs of its farm policies. It has also increased the EC's exposure to other countries' farm policies in its competition for world markets. Many leaders in the European Community now perceive that their countries stand to gain somewhat by multilateral policy reform. France, a long-time proponent of high support prices, favors reform. The EC position is complicated, however, by the need to obtain agreement from all 12 members for any policy change (West Germany opposes most reform).

The European Community appears committed to maintaining the structure of its Common Agricultural Policy, though it may be willing to reduce support levels somewhat to mitigate its problem of oversupply. It favors arrangements to share markets, while it hangs back from rules that would define the acceptable trade policies that can be used to achieve those shares. Any major reduction in the EC's farm support levels would have to be matched by similar concessions by the United States as a matter of principle--even when such concessions would not be of direct benefit to the EC. The Europeans, like the United States, are exerting considerable pressure for agricultural reform in Japan.

Japan

Japan is the only developed country in the negotiations that is strongly against major agricultural policy reform. Japan holds that since it is the world's largest importer of many farm commodities, its highly protective national farm policy does not seriously distort world markets and therefore should not be a subject of negotiation. Exporting countries do not accept this position, noting that Japanese import levels would be considerably higher if protection were reduced, thus expanding world demand for many farm products. An undercurrent to the negotiations on Japanese farm policies is the possibility that a refusal by Japan to open its agricultural markets might lead other countries to retaliate against Japanese exports of manufacturing products.

The Cairns Group

Agriculture is far and away the most important issue in the Uruguay Round for most of the 13 members of the Cairns Group. These countries depend heavily on agricultural exports for the viability of their farm sectors and for foreign exchange earnings. They have suffered considerably from the depression in world commodity prices, much of which they attribute to other countries' farm programs. [25] The Cairns Group want the United States and the EC to lower production incentives for grains, and Japan and other countries to lower import barriers. They also want GATT revised so as to enhance the rights of third countries that are injured by the unfair trade policies of rival exporting countries. Australia refused to reduce nonagricultural protection significantly during the Tokyo Round because of lack of progress in agricultural reform, and it has restated this position for the Uruguay Round as well. New Zealand has undertaken significant reforms in agricultural policies unilaterally, and wants to receive reciprocal credit for these actions during the multilateral talks. Developing countries, both in and out of this group, want increased access to developed-country markets, especially for tropical products and processed agricultural products.

Each of the developed countries in the Cairns Group, especially Canada, supports and protects some commodity producers, and would be expected to liberalize these programs. Developing countries in the group may be asked to reduce some of their agricultural protection, but on a much smaller scale than the developed countries.

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25. The Cairns Group countries were much less concerned over U.S. agricultural policies during the early 1980s when the United States acted to prop up world prices. But the U.S. policy change in the 1985 farm bill that substantially reduced world prices for grains elicited an angry response. These countries have consistently fought against EC farm policies.

IMPLICATIONS OF TRADE LIBERALIZATION FOR U.S. AGRICULTURE: TWO SCENARIOS

The consequences of agricultural trade liberalization would depend on the degree, form, and pace of policy change agreed to, on conditions in domestic and world economies, and on the agricultural policies that would have existed in the absence of a negotiated agreement. A major shift in farm policies would affect not only farmers but consumers, merchants, processors of farm products, and suppliers of agricultural inputs. This section examines two scenarios for liberalization that have received prominent consideration.

Trade Liberalization Scenarios

The primary objective of both scenarios is a substantial decrease in governments' involvement in agricultural markets, especially in giving farmers incentives to produce well in excess of need. One scenario is a phased rollback of current domestic subsidies. This approach would maintain the same price and income support structure currently employed by national farm policies, but would reduce the support levels significantly over time. The second scenario, often called "decoupling," would entail a fundamentally new policy framework; it would phase out current policies (such as deficiency payments, price supports, and acreage controls in the United States) and replace them with direct payments that would be unrelated to production levels and might be based on economic need.

Effects of the Scenarios on U.S. Agriculture. Current programs induce overproduction and, in the case of U.S. acreage controls, lead to misallocation of resources. Curtailing such programs would yield overall benefits for almost every country. At the same time, where government support levels are high, net farm income could drop considerably. For example, well over half of the net income of many U.S. producers of wheat and corn comes from direct government payments.[26] Declines in farm income could be ameliorated somewhat by the improvement in world market conditions that would probably result if such reforms were made simultaneously in all major trading countries.

26. This possibility does not imply, however, that reducing government payments to these farmers, along with acreage controls, would reduce their net income by the same amount. Acreage controls offset the benefits of the support payments, so that net farm income would likely fall by less than the drop in government payments.

Agricultural employment would probably decline somewhat if government support policies were reduced significantly. Some adjustment aid, including training and financial assistance, might be provided to farmers leaving agriculture; and some of the savings derived from reducing farm supports could be redirected to diversifying rural development. But agricultural employment, and the proportion of farm family income earned in farming activities, have been declining for many years because of better job opportunities elsewhere. In the long run, cutbacks in support policies would not affect the general tendency for returns to employment in agriculture to approach returns outside of farming.

The main long-term impact of reduction in government support policies would be on the value of assets tied to agricultural production, particularly land. Land prices would drop to the extent that expectations of continued government support are capitalized into the value of the farmland. Present farmers would lose the most because the value of their farms incorporates the expectation of continued federal support, and some of the value of this expected government support was reflected in the price they paid for their farms. Land prices have fallen precipitously in recent years, partly reflecting expectations that current high levels of support, at least for grains and cotton, could not be maintained. These declines may already have absorbed much of the loss from future policy reform.

The effect of worldwide reductions in agricultural support on prices would vary among commodities, depending mostly on the type and extent of present protection here and abroad, and on the reforms that were adopted. The prices of dairy products and sugar, the commodities that receive the most price protection in the United States, would decline as import restraints were reduced and as domestic price support levels fell. World prices of these commodities would increase, at least in the short run, because of declining world production and increasing world consumption. The U.S. dairy industry would probably contract. Similar, although probably more significant adjustments, might be required in the U.S. sugar industry.

Beef prices would tend to increase here and abroad, in the short term, as lower levels of protection in Japan and the European Community led to increased consumption. The effect of liberalization on prices of other major commodities is less clear. One recent study estimated that the net effect of complete liberalization of agricultural trade in the developed industrial market countries would be relatively small increases--less than 5 percent--in U.S. and world prices for wheat and coarse grains. 27/ However, the base

27. Rodney Tyers and Kym Anderson, "Distortions in World Food Markets: A Quantitative Assessment" (background paper for the World Bank's *World Development Report*, 1986).

period for this study was 1980; at the current low prices for most grains, policy reforms would be likely to increase grain prices by much more.

Effects of the Scenarios on U.S. Farm Programs and Federal Spending. The historical commitment of the U.S. government to its agricultural sector would not be likely to end if trade was liberalized. A decoupling of production subsidies from income supports would allow the government to continue assisting farmers while removing some of the existing incentives to excess output and inefficient production. Transition payments could be provided to all farmers to assist them in the shift toward freer markets. More permanent forms of assistance could be designed for purposes of social welfare or rural development.

Current U.S. programs for grains and cotton have some characteristics of decoupling: deficiency payments are not now tied to current production, and some portion of them may be received without producing the supported crop on all permitted acres. Also, for most grains and cotton, once the effect of marketing loans and the export enhancement program is taken into account, market prices would probably not fall substantially if U.S. price supports were withdrawn. This means that most of the adjustment under a decoupling scenario would entail changes in the form, and amount, of government payments, and not in prices--at least as long as current market conditions continue.

Decoupling in dairy and sugar farming would involve somewhat different procedures, since consumers now pay much of the cost of the subsidy to these producers. Market price supports would have to be reduced, and compensation for all or part of the income loss could be made through direct government payments, which might be phased out over time or continued indefinitely. In the case of the sugar program, which now entails no cost to the government, any payment made to current producers would require an increase in government spending. Full compensation for lost income to sugar producers would be quite costly. The President's 1988 budget included a proposal to cut sugar price supports by one-third and to provide nearly full compensation to current producers during the first year through direct government payments. The payments would be reduced annually and eliminated in the fifth year. This program, which resembles what might happen in the event of trade liberalization, would cost the government nearly $700 million in the first year, though gains to consumers would be even greater. It has not received serious attention by the current Congress, perhaps because it would increase federal outlays. However, it might gain support as part of a broader trade liberalization package.

For dairy farmers, full compensation for lost income could also be quite expensive to the government because much of their current support is paid by consumers through high prices rather than directly by the government. Fully compensating the losses to grain, cotton, and soybean producers would probably reduce federal spending, since most support for these crops currently comes from the government rather than from consumers, but this would depend critically on the scope of the compensation scheme.

If, instead of decoupling, the current set of U.S. farm programs was simply adjusted downward, federal expenditures would be affected in diverse ways. Government expenditures would probably fall, although it is impossible to estimate by how much without knowing how these programs are to be curtailed. Federal outlays for current farm programs are projected to average roughly $20 billion annually over the next five years. Additional federal spending on agriculture includes credit programs, federal subsidized crop insurance, and research and education programs.

Other federal programs are designed to stimulate exports. These include the Export Enhancement Program (EEP), export credit guarantees, and food aid to developing countries. The EEP, which subsidizes exports of grains, especially wheat, costs between $200 million and $300 million annually. Full elimination of this program would reduce federal spending by the same amounts. Export credit guarantees, which help to finance export sales of agricultural commodities, involve federal outlays only when loans are defaulted. Past outlays for this program have been around $250 million annually, but it is budgeted to spend between $500 million and $600 million annually in the next two years. The cost of food products given as in-kind aid to developing countries is minimal, but there are some processing and transportation costs associated with this program. It is unlikely that cutbacks in export credit guarantees or in food aid will be addressed during these negotiations.

CHAPTER V

MATURE INDUSTRIES: AUTOMOBILES, STEEL, TEXTILES AND APPAREL

Import restraints and export subsidies have been important in shaping trade in mature industries such as textiles, apparel, steel, and automobiles. These industries, so important to many developed economies, have suffered from diminished growth in demand, displacement by new technologies, and competition from producers in other countries.

The General Agreement on Tariffs and Trade was designed to limit government protection of firms competing in international markets. GATT permits a government to restrict imports temporarily, however, to allow an industry to adjust to increased international competition stemming from trade liberalization. GATT also permits certain kinds of subsidies, although it prohibits direct subsidies of exports.

Thus many government efforts to defend mature industries violate the spirit if not the letter of the General Agreement. For example, countries frequently agree to limit their exports at the request of an importing country; such voluntary export restraints are not prohibited by GATT, which applies only to unilateral restraints imposed by importing countries. Likewise, GATT permits countries to subsidize an industry so long as the subsidies do not injure firms in other countries. Such subsidies do not directly stimulate exports, but affect producers in other countries by increasing world supplies and lowering prices.

Participants in the Uruguay Round will discuss ways of reducing trade restraints and subsidies and will try to develop rules to limit their future use. They will be mindful, however, that international competition may lead to further restructuring of some mature industries and will seek ways to reduce the costs of "adjustment." Since GATT imposes less stringent standards on developing countries, the Uruguay Round will also consider how to apply the rules of international trade to newly industrialized countries as they mature.

The automobile, steel, textile, and apparel industries are among the oldest and largest industries in the United States and other industrially developed countries. Over the last several decades, however, they have faced increasing international competition. Governments have sought to aid these and other mature industries by giving them subsidies and creating barriers against imports. Similar policies have been used by developing countries in the hope of speeding the growth of their economies.

Such policies have to some extent shielded mature industries from the recent dramatic changes in trade patterns. Though the U.S. trade deficits in automobiles, steel, textiles, and apparel have been large and, with the exception of steel, increasing, other industries have accounted for a larger part of the deterioration in trade during the 1980s. In 1981, for example, these three industries ran a combined trade deficit of $28 billion, while overall U.S. manufacturing recorded a narrow surplus (see Table 12). By 1985, the balance of trade for all U.S. manufacturing had declined by $117 billion, and these three industries accounted for one-third of the deterioration. In the European Community, the trade surplus of these industries grew by 1 percent between 1981 and 1985, while that for all

TABLE 12. TRADE BALANCES BY PRODUCTS AND COUNTRIES (In current dollars)

Year	All Manufacturing	Automobiles	Textiles and Apparel	Steel
		United States		
1981	5,010,513	-13,187,312	-6,324,556	-9,268,858
1982	-11,102,917	-18,164,291	-7,884,105	-8,187,905
1983	-38,987,566	-22,853,218	-10,452,276	-5,933,614
1984	-87,933,576	-30,341,355	-15,993,459	-10,510,576
1985	-112,088,215	-39,293,177	-18,101,751	-9,965,951
		European Community		
1981	99,982,863	17,858,418	-1,687,212	13,191,542
1982	94,635,322	18,017,718	-1,448,884	9,658,090
1983	89,456,027	15,804,283	-597,258	8,450,895
1984	89,718,235	16,556,211	-32,949	9,703,867
1985	96,248,013	18,388,893	869,398	10,482,929
		Japan		
1981	115,777,291	31,948,491	2,994,779	15,602,124
1982	104,269,225	29,204,066	2,194,812	14,429,255
1983	110,649,306	31,027,939	2,993,576	11,494,579
1984	128,283,515	35,673,449	2,236,095	11,940,355
1985	134,480,345	40,920,934	1,759,826	12,086,342

SOURCE: United Nations and Congressional Budget Office.

NOTE: "All manufacturing" includes Standard International Trade Classifications 5, 6, 7, 8, and 9.

manufacturing declined by 4 percent. In Japan, where the overall trade balance improved, two of the three industries remained flat and only automobiles increased its surplus. In the newly industrialized countries, the trade balance improved markedly, going from a deficit of nearly $5 billion in 1981 to a surplus of over $20 billion in 1985. Industry data for these countries, however, were not available. 1/

Nevertheless, the developed nations have had only limited success in shielding these industries from the discipline of the marketplace. Competition from abroad has been a factor, but it is rarely the only reason for a protected industry's difficulties. A slowdown in the growth of domestic consumption, coupled with increased productivity and changing tastes, often plays a critical role. Trade restraints in themselves frequently afford only limited protection. In the case of quotas, the most important trade barrier, foreign producers not covered by the restraints tend to increase their exports while those who are constrained by them tend to shift their product mix toward more expensive goods.

This chapter scrutinizes the use of subsidies and nontariff trade barriers to protect mature manufacturing industries. Negotiations in the Uruguay Round over these policies will be of particular importance to the automobile, steel, and textile and apparel industries.

CURRENT PROBLEMS IN MATURE-INDUSTRY TRADE

When the sales of an industry decline and force it to contract, most of the costs of adjustment are borne by the labor employed in the industry. Government can aid the industry by directly subsidizing it or by erecting barriers against its foreign competitors. These policies impose costs on producers in other nations, because subsidies and trade restraints increase the world's supply of the product and put downward pressure on world prices. Despite the gains to the aided industry, these policies also impose costs on the nation employing them, particularly by discouraging resources from moving to sectors where they might be more productively used. The costs of the policies will increase if other countries retaliate by imposing trade restraints or providing subsidies to help their own firms.

1. The newly industrialized countries include Brazil, Hong Kong, South Korea, and Singapore. Data on their trade balances is from Wharton Economic Forecasting Associates, *World Economic Service Historical Data* (Philadelphia: Wharton, January 1987).

Trade Restraints

Barriers to trade generally take the form of tariffs or quotas. In the industries considered here, quotas are widely used.[2] Quotas, or quantitative limits on imports, are often arrived at by mutual agreement in which the exporting country agrees to limit its exports to the importing country.[3] Such voluntary export restraints are not covered by GATT, which applies only to unilateral restraints imposed by importing countries. GATT gives developing countries even wider latitude in protecting their industries. The developing countries have been largely exempt from previous rounds of tariff reduction, and they have also erected numerous nontariff barriers to foster the growth of emerging industries. Increasingly, the United States and other developed countries have begun to retaliate or to threaten retaliation against trade barriers erected by developing countries.

GATT permits trade restraints for only a limited time, to give an industry a chance to adjust to increased international competition.[4] In the three industries considered here, however, trade restraints have tended to persist. Moreover, the restraints are often extended to other products or countries as time goes by. And restraints imposed by a major country such as the United States (or a bloc of countries such as the European Community) often elicit similar actions from other countries.

The Quasi-permanence of Trade Restraints. The persistence of restraints can be seen in many mature industries. Since the 1950s, restraints on textile and apparel products have expanded principally through a series of multilateral agreements--of which the current one is the Multifiber Arrangement--that establish rules by which developed countries can limit imports from developing countries. Although these agreements and arrangements always have expiration dates, the parties invariably renew them. This system has developed in spite of the fact that tariffs in these industries are

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2. Under GATT, a country can impose quotas unilaterally only to rectify balance-of-payments difficulties. GATT permits trade restraints in aid of an industry that has been injured or threatened with serious injury by trade liberalization.

3. Though mutually-agreed-upon quotas are often announced, there are apparently instances in which limitations on exports are the result of nonpublic understandings between governments. In addition, countries have sometimes quietly taken unilateral administrative actions, such as restrictive customs or inspection procedures, to impede imports.

4. When a nation protects an industry that has been injured by a trade liberalization, Article XIX of GATT allows affected countries to withdraw equivalent concessions that they had made.

higher than in other manufacturing industries. As originally conceived, the agreements were intended only to facilitate more orderly trade, not to provide permanent protection. As now administered, both by the United States and by the European Community, the aim seems to be to preserve the size of the domestic industries. 5/ In the United States, for example, the outputs of the textile and apparel industries have remained relatively stable since the Multifiber Arrangement was put into place in 1974. 6/ While employment has declined, this has been largely the result of increased productivity, which has been especially rapid in the textile industry. Similar trends are evident in Europe. 7/

Quotas in the automobile industry have appeared more recently and are aimed mainly at Japan. While they have not been the product of a formal multilateral process, as in textiles and apparel, they are also proving to be long lasting. This is most clearly illustrated by the experience in the United States, the largest export market for Japanese cars. The 1980 recession, coupled with rising gasoline prices, contributed to a nearly 30 percent decline in domestic car sales with unprecedented industry losses. During that same year, sales of Japanese imports rose by 40 percent. In the spring of 1981, President Reagan negotiated a voluntary restraint agreement with Japan. Although the arrangement was to be temporary, it was renewed in each of the following three years; since then, Japan has unilaterally restricted its automobile exports to the United States. 8/

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5. Clayton Yeutter, the U.S. Trade Representative, has claimed that the President was committed to relating "total import growth to the rate of growth of the domestic market." Seventy-seven Senators and 302 House members had sent letters to President Reagan to limit growth to the rate of growth of the domestic market. See *Inside Trade*, July 11, 1986, p. 2.

6. See testimony of Walter Lenahan, Deputy Assistant Secretary, Department of Commerce, before the Subcommittee on Commerce, Consumer and Monetary Affairs of the Committee on Government Operations, March 6, 1985.

7. Between 1976 and 1985, EC production of textile, clothing, and leather declined at an average annual rate of less than 1 percent per year. Employment declined at an average annual rate of approximately 2.5 percent.

8. Japan agreed to export 8 percent fewer cars to the United States in the year ending March 31, 1982, than it had in 1980. Japan later agreed to maintain the same level of imports for another year. The level was increased by 10 percent for the next two years. Despite the expiration of the voluntary agreement in 1985, Japan elected to continue restricting its exports. With the decline in the value of the dollar, and increased car production by Japanese firms in the United States, the quotas may have little impact on U.S. imports during 1987.

The United States is not alone in restricting the sale of imported cars. In 1976, Italy limited Japanese imports to 2,200 cars per year; in July 1986, it raised the limit to 3,300 per year. France does not permit Japanese imports to exceed 3 percent of domestic new car sales. 9/ Both Spain and the United Kingdom have had restraint agreements with Japan to limit Japanese auto imports. Because sales of Japanese cars in other European markets have been increasing, the EC has apparently prevailed upon Japan to limit voluntarily its car exports to Europe beginning in 1987. 10/

In addition to explicit limits on trade, a number of countries have established "local content" regulations that effectively prohibit the sale of imported cars. For the most part, these regulations were adopted before Japan emerged as an important supplier of automobiles. For example, 85 percent of the value of cars sold in Australia must come from domestic parts and labor. Spain has had a local content requirement of 55 percent, which it agreed to phase out with its entry into the European Community. 11/ Such local content requirements are also widespread in developing countries and in Latin America.

Although steel trade is not governed by a multilateral trade agreement, most major steel-consuming nations have imposed some restraints. The United States has protected the steel industry on three different occasions. 12/ Most recently, in the fall of 1984, it negotiated voluntary export restraints with countries that are its principal steel suppliers. Voluntary export restraints had previously been negotiated with the EC and Japan in the late 1960s; these were renewed once, and expired in 1974. In 1978, the United States established trigger prices; imports below those levels were subject to accelerated anti-dumping proceedings.

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9. See "Japanese Makers Gain Market Share in Europe," *Automotive News*, July 7, 1986, p. 35.

10. See "Company Brief; Toyota Learns to Sprint," *Economist*, January 12, 1987, p. 75.

11. See International Trade Commission, *The Internationalization of the Automobile Industry and its Effect on the U.S. Automobile Industry*, Publication 1712, June 1985.

12. The United States imposed countervailing duties in a number of cases after it was found that foreign firms sold steel below cost. And allegedly there have been a number of informal agreements to limit imports at times when explicit restraints were not in effect. See Gary Clyde Hufbauer and others, *Trade Protection in the United States* (Washington, D.C.: Institute for International Economics, 1986), pp. 170-174.

Europe has also restrained trade in steel over a period of years. In 1979, as conditions in the industry deteriorated, the Commission of the European Communities declared a "manifest crisis" under the Treaty of Paris. [13] This enabled the Commission to establish minimum prices and quotas for steel products sold in Europe, as well as requiring that subsidies and expansion plans be approved by the Commission. [14] The European Community also negotiated bilateral agreements with 14 major supplying countries and established minimum import prices for other foreign suppliers. Though these measures were meant to be temporary, the Europeans have not yet completely shed them.

Although Japan no longer explicitly limits steel imports, it imports little steel from Korea, which emerged as an important low-cost producer in the 1980s. Also, an official of the EC has recently complained about restricted access to the Japanese market. [15]

The Increasing Scope of Trade Restraints. A quota established to protect an industry usually applies to the industry's principal competitors and rarely to all the world's producers; it thus conflicts with the principle of nondiscrimination, which is basic to GATT. One result of such discrimination is to give firms in unconstrained countries an incentive to increase exports to the protected market. Moreover, producers that are subject to the constraints often respond by focusing on higher-valued products under the quotas and also by increasing their sales of substitute products that are not covered. The importing country often reacts by broadening the scope of a quota to cover additional countries and products, as well as by defining products more precisely to limit upgrading by foreign producers.

Experience in the textile and apparel industry vividly illustrates how restraints tend to expand. At first, quotas covered only exports of cotton products from Japan to the United States and the United Kingdom. The

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13. Under the Treaty of Paris, many European countries have delegated substantial authority to the Commission at times of "manifest crisis." See Raymond Levy, "Industrial Policy and the Steel Industry," in William James Adams and Christian Stoffaes, eds., *French Industrial Policy* (Washington, D.C.: Brookings Institution, 1986), pp. 63-74.

14. See International Trade Commission, *Foreign Industrial Targeting and Its Effects on U.S. Industries, Phase II: The European Community and Member States*, Publication 1517 (Washington, D.C.: April 1984).

15. See "EEC Intends to Ease Restraints," *American Metal Market*, December 3, 1986, p. 3.

subsequent growth of cotton exports from Taiwan, Korea, and other countries led to restraints on those. As imports of non-cotton products expanded, quotas were first placed on synthetics and wool, then on silk, linen, and ramie. In addition, the number of cotton and textile products subject to quotas also increased. Thus, over time, both the number of countries and the number of products covered by restraint agreements have increased.

A similar expansion has occurred in steel, where U.S. restraints on steel imports have covered an increasing number of countries. The first round of restraints included only Japan and the six original members of the European Community. The most recent round involves substantially more countries, and several of the agreements contain detailed product classifications. 16/

How Protection Breeds Protection. A government's decision to limit imports gives the constrained exporters incentives to divert their output to other countries. This in turn increases the pressure on other governments to impose trade restraints.

At the time the United States entered into its voluntary restraint agreement with Japan to limit imports of Japanese cars, West Germany was given assurances that Japan would not divert the cars to its market. These assurances apparently did not last as long as the restraints on Japanese car sales in the United States, because sales of Japanese cars in Germany and other European countries have increased in recent years. The restraints on exports to the United States may have accelerated the growth of Japanese exports to Europe and contributed to the recent agreement that limits Japanese car exports to the EC. 17/

A similar pattern may be at work with textiles and apparel. Despite the framework of multilateral agreements, quotas are negotiated bilaterally. Some maintain that the runup of textile and apparel exports to the United States during the 1980s stemmed from the more restrictive quotas the EC negotiated in the 1980s. 18/ While the value of U.S. apparel imports from developing countries increased by more than 90 percent between 1980

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16. See Congressional Research Service, *The President's Steel Import Program: One Year Later*, October 16, 1985.

17. See "Company Brief: Toyota Learns to Sprint," *Economist*, January 17, 1987, p. 75.

18. Thomas Howell and William Noellert, *The EEC and The Third Multifiber Arrangement: A Study Prepared for the Fiber, Fabric, and Apparel Coalition for Trade* (Washington, D.C.: Dewey, Ballantine, Bushby, and Wood, 1986).

and 1984, Europe's imports from these countries (measured in dollars) declined by 13 percent. Similarly, U.S imports of textiles from developing countries increased by 70 percent, while European imports declined by 20 percent. As a result, the U.S. textile and apparel trade deficit with developing countries swelled, while the EC's declined (see Figure 2). 19/ Also important, of course, were the strength of the dollar and the more rapid growth of the U.S. economy during this period.

In any case, the higher textile and apparel imports into the United States created pressure to provide the industry with more relief. For example, the Congress passed a bill, vetoed by President Reagan, that would have placed tighter limits on imports from developing countries. Before the most recent extension of the Multifiber Arrangement, the United States negotiated much tighter quota limitations with a number of its major suppliers.

Subsidies

Negotiations in the subsidy panel of the Uruguay Round are likely to have a profound influence on mature industries. GATT is more ambiguous on the issue of subsidies than on trade restraints. While acknowledging that subsidies to firms competing in international markets distort trade flows, the General Agreement recognizes the right of a country to subsidize firms to "promote important objectives of social and economic policy." 20/ It notes, for example, that subsidies can legitimately be used to help economically disadvantaged areas, to facilitate restructuring, or to maintain employment.

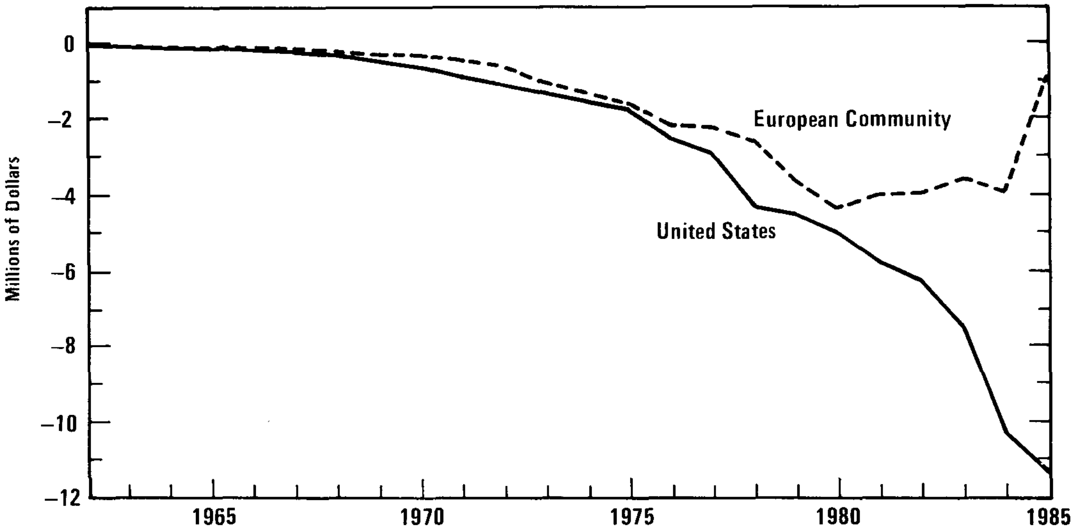
GATT tries to balance the rights of nations to subsidize an industry with its own goal of promoting international competition. It therefore maintains different standards for different types of subsidies, and imposes less stringent standards for developing nations. GATT flatly prohibits subsidies that lower the price of an exported manufactured product below its domestic price. 21/ It prohibits other subsidies, however, only when they

19. A sharp decline in the EC's textile exports more than offset the fall in imports, so its textile trade balance deteriorated by roughly the same amount as the United States' textile trade balance.

20. Gary Hufbauer and Joanna Erb, *Subsidies in International Trade* (Washington, D.C.: Institute for International Economics, 1984), pp. 13-16. Appendix A of that book reproduces the relevant articles of the GATT and an agreed interpretation of those provisions.

21. See Article XVI:4 of the General Agreement. Limited export subsidies are permitted in the case of some primary products.

Figure 2.
Apparel Industry: Trade Balances of the United States and the European Community with Developing Countries



SOURCES: Congressional Budget Office; United Nations.
NOTE: The trade balances are exports to developing countries minus imports from them. The developing countries include all apparel-exporting countries that are not mature industrial countries.

cause or threaten to cause material injury to firms in other countries. 22/ After finding material injury, the government of the injured party can impose countervailing duties in the amount of the subsidy.

Developing countries' use of export subsidies is limited only to the extent that they adversely affect firms in other countries. In such a case, the developing country is obliged only to "endeavor to enter into a commitment to reduce or eliminate the subsidy." It can continue to provide other types of subsidies as long as it adheres to the commitments it has made under the agreement.

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22. Evidence of material injury includes falling output, profits, or employment. Subsidies that merely reduce the rate at which an industry's output or profits grow do not violate the agreement.